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RUEATRS/DEPT OF TREASURY WASHINGTON DC  
RUEHBK/AMEMBASSY BANGKOK 0101  
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RUEHMO/AMEMBASSY MOSCOW 0001  
RUEHNE/AMEMBASSY NEW DELHI 0012  
RUEHGP/AMEMBASSY SINGAPORE 0020  
RUEHBJ/AMEMBASSY BEIJING 0642  
RUEHRL/AMEMBASSY BERLIN 0001  
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USDOC FOR 4420/ITA/MAC/CEA/MCQUEEN  
USDOC ALSO PASS TO NIST AND BEA  
STATE PASS USTR  
USTR FOR STRATFORD/WINTER/MCCARTIN/ALTBACH/READE  
TREASURY FOR OFFICE OF INTERNATIONAL INVESTMENT  
TREASURY FOR OASIA/ISA -- DOHNER, HAARSAGER AND CUSHMAN  
GENEVA PASS USTR  
PARIS PASS TO USOECD

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SUBJECT: INNOVATION REQUIRED FOR CHINA'S ECONOMIC GROWTH

REF: BEIJING 23856

11. (SBU) Summary: The National Bureau of Statistics and the U.S.-based Conference Board hosted a national forum on Innovation and China Economic Growth October 20- 22 in Suzhou, Jiangsu Province. During the conference, PRC officials from the Chinese People's Political Consultative Conference (CPPCC), National Bureau of Statistics (NBS), People's Bank of China (PBOC) and the Shanghai Stock Exchange, as well as representatives of foreign multinational corporations, discussed "self-innovation" and identified systemic changes necessary to foster innovation in China. The systemic changes included: increased IPR protection, financial sector liberalization, openness to the world, and creation of a society in which failure was acceptable. End summary.

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CHINA: Big, but not Strong  
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12. (U) CPPCC Vice Chairwoman Zhang Meiyang stressed in her keynote address the importance that China's leadership has placed on innovation. Zhang said that while China's total GDP made it the fourth largest economy in the world, on a per capita basis, China ranked only 110th in the world. This showed that China was a big country, but not a strong country. According to Zhang, under President Hu Jintao's leadership, China has decided

that the way to create strength from size is through self innovation.

¶3. (U) Zhang said that rapid growth over the past twenty years had placed strains on national resources that would lead to decreased economic development. China needed to rely on innovation to create a foundation for sustainable growth. China had a low proportion of clean, high-technology industries. China's leadership realized that the environment was not a free commodity and that environmental damage would devour many of China's economic gains. While China manufactured low-technology items, it was dependent on other countries for its high-technology needs. Additionally, China's consumption of energy and raw materials per unit of production far exceeded that of developed world and was not sustainable, she said. If China did not develop its own human resources, China would continue to be only the manufacturing base for the rest of the world.

¶4. (U) According to Zhang, in major industries, such as the petroleum and electronics industries, China was dependent on imported technology for 75-80 percent of its needs. She said that China needed to learn to innovate to create its own core technologies. She said that China needed to "digest technologies from other countries" before it could "re-innovate these technologies for other purposes." China needed to generously fund its own scientists to insure its "leap-frog in development." She also criticized the "longstanding planned economy mindset" in China that meant that companies were too passive -- not taking on risks or investing in the future. As a result, she said, these companies were not positioned for success, and China lagged behind. Zhang's speech was widely quoted and referred to by other government speakers during the course of the weekend conference.

SHANGHAI 00007085 002 OF 004

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What is Innovation?  
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¶5. (SBU) When asked how the Chinese government defined "self-innovation," National Bureau of Statistics (NBS) China National Research Association Secretary General Zhang Zhongliang said: "China is a big country, but it has no power. China needs to import 90 percent of its technology. China needs to develop its own name-brands and self-proprietary technology so that it can build a strong economy. To be a strong country, China needs to develop its own innovative abilities."

¶6. (U) In his talk, Development Research Center of the State Council (DRC) Deputy Director Liu Shijin outlined what was meant by self-innovation. He said that the three kinds of innovation are prime innovation, re-innovation, and the integration of innovation from abroad into China. Liu said that foreign companies with investments or joint ventures in China had expressed their concern with China's emphasis on self-innovation and begun to limit their investment in innovative areas. He tried to put them at ease by explaining that any innovation done in China by foreign companies located here was actually "Chinese self-innovation" because ultimately these companies would contribute to the building of China and its capabilities. Ministry of Commerce Vice Minister Shang Ming was more explicit when he said, "Self-innovation does not rule out the importation of innovative technologies from abroad."

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Requirements for Innovation - IPR and Financial Reforms  
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¶7. (U) Multiple speakers from Microsoft Chief Research and Strategy Officer Craig Mundie to Peking University Guanghua

School of Management Dean Zhang Weiying emphasized China's need to create an environment that would allow innovators to be financially rewarded for the risks they took to innovate. They cited the need for real intellectual property rights to protect innovation and a competitive financial sector that fostered "innovations" such as venture capital and other mechanisms for the efficient distribution of financial resources.

18. (U) People's Bank of China Vice Governor Su Ning said that due to increased global competition, China needed to tear down restrictions in the financial sector. He said that Chinese banks needed to reform and innovate in order to increase their margins of profitability. He also said that China needed to reform its regulatory framework to allow for financial products such as bonds, funds, options and other ways to diversify financial risk. He stressed that China needed a unified credit database to enable efficient access to financing.

19. (U) Shanghai Stock Exchange (SSE) President Zhu Congjiu noted that while there was 30 trillion RMB (about USD 3.8 trillion) worth of capital available in China, Chinese companies had a "weak capability to engage in venture capital." He said this

SHANGHAI 00007085 003 OF 004

was why quality companies chose to go public abroad, rather than in China. It also meant, he added, that 83 percent of all venture capital in China was from foreign sources. According to Zhu, the SSE planned to make the reforms necessary to keep Chinese companies in China by creating an environment where they would have access to the capital they needed domestically. In response to a question, Zhu admitted that for the financial sector, "innovation" actually meant reforming the Chinese system to be more like the international financial market standard.

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Innovative Translation -- Some Words Left Unsaid  
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110. (SBU) The conference theme as translated in English was "Innovation and China Economic Growth." In Chinese, however, the title was "Self-Innovation (Zizhu Chuangxin) and China Economic Growth." Chinese government speakers all used the word "self-innovation," but the translators uniformly translated it as "innovation." Conference speaker European Union Economics and Regional Officer Leila Fernandez-Stembridge noted to Econoff that this appeared to be an intentional "mistranslation." Price Waterhouse Coopers Senior Advisor Kenneth DeWoskin, another conference speaker, speculated that a political decision had been made to de-emphasize the Chinese-centric focus on "self" in an attempt to soften the tone of the conference.

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When Innovation Means Using an Airbrush  
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111. (SBU) DeWoskin noted to Econoff that the "palpable unspoken undercurrent" had been the sacking of NBS head Qiu Xiaohua eight days before the conference in connection with the Shanghai pension corruption scandal. No mention of Qiu was made publicly, even when Xie was introduced as only having been on the job for a week. An NBS employee who helped organize the conference materials told Econoff about the "huge amount of work" that he had to re-do in replacing Qiu Xiaohua's information and name with that of new leader Xie Fuzhen in all of the many professionally produced bound conference materials. An NBS press officer commented that his office had been given no notice of the sacking and been inundated with "questions we cannot answer."

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Challenges Facing Innovation in China

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¶12. (SBU) Sixteen non-governmental speakers at the conference, including Sun Microsystems Vice President Piper Cole, GE China Technology Center Managing Director Bijan Dorri, and The Conference Board Executive Vice President Gail Fosler, China were tasked with outlining how China could create and nurture an environment that led to innovative people and companies. These speakers described several challenges that China faced to its

SHANGHAI 00007085 004 OF 004

drive for self-innovation, including:

- China needed to stay open to the world. Innovation would be greatly hampered in a closed system.
- China needed to avoid "nationalizing" or "branding" its innovations in a way that would limit its global reach. By creating a "China standard" different from global standards, China would shut itself out of competition.
- China needed to protect intellectual property rights in order to protect those who had taken risk.
- China needed to create the financial market conditions that would support venture capital in order to reward risk takers.
- China needed to create a social milieu in which failure was acceptable. If the price of failure was too high, no one would take any risks.
- China needed to develop educational systems that continued to foster interest in math and science.

¶13. (SBU) Chinese government speakers appeared receptive and largely agreed to the above list of prescriptions. However, they tended to stress the importance of Chinese brands and standards being the mark of Chinese innovation. As one speaker commented, "We hope that the day will come when the label does not read 'Made in China' but 'Created in China.'"

¶14. (SBU) Comment: Innovation -- or self-innovation -- has clearly been identified as the next necessary step in China's economic development strategy. While the mission is clear, China still faces enormous systemic economic, legal, educational and social barriers to create an innovation-friendly environment.  
JARRETT